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“Can taxes tame the banks? Evidence from the European bank levies”

Abstract

In the wake of the financial crisis, a number of countries have introduced levies on bank borrowing with the aim of reducing riskiness in the financial sector. This paper studies the behavioral responses to the bank levies and evaluates the policy. We find that the levies induced banks to borrow less but also to hold more risky assets. The reduction in funding risk clearly dominates for banks with high capital ratios but is exactly offset by the increase in portfolio risk for banks with low capital ratios. Hence, while the levies appear to have reduced the riskiness of relatively safe banks, they have done nothing to curb the riskiness of relatively risky banks, which presumably pose the greatest threat to financial stability.